STAFF PAPER

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REG IASB Meeting

Project	**Leases**
Paper topic	Effective Date

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Objective

1. The objective of this paper is to discuss the effective date of the new *Leases* Standard.

2. This paper is structured as follows:

   (a) Summary of staff recommendations

   (b) Background

      (i) 2013 Exposure Draft and feedback received

      (ii) Relevant decisions made during redeliberations - transition

      (iii) Recently issued Standards

   (c) Outreach

   (d) Staff analysis

      (i) Effective date

      (ii) Early application

      (iii) Interaction with other recently issued Standards

   (e) Staff recommendations and questions for the IASB

   (f) Appendix: Costs for preparers of implementing the new *Leases* Standard

3. The drafting of the new *Leases* Standard is progressing in accordance with the planned timetable. The staff expect that the new *Leases* Standard will be ready for publication before the end of 2015.

Summary of Staff Recommendations

4. The staff recommend that the IASB:

   (a) requires entities to apply the new *Leases* Standard for annual periods beginning on or after 1 January 2019.

   (b) permits early application of the new *Leases* Standard, subject to the recommendation in paragraph 4(c) below.

   (c) prohibits entities from applying the new *Leases* Standard before applying IFRS 15 *Revenue from Contracts with Customers* (an entity would be permitted to apply both the new *Leases* Standard and IFRS 15 for the first time in the same reporting period).

Background

2013 Exposure Draft and feedback received

5. The 2013 Exposure Draft *Leases* (2013 ED) did not contain a proposed effective date. Nonetheless, a number of respondents to the 2013 ED provided views on what the effective date of the new *Leases* Standard should be. Virtually all of these respondents noted that a significant period of time would be required between publication of the new *Leases* Standard and its effective date. The majority of respondents suggested that this period should be between three and five years. Some respondents noted that this was because the transition proposals that were included in the 2013 ED were complex and did not provide any substantial relief compared to a fully retrospective transition approach. In particular, many respondents identified the need to restate comparative periods as increasing the length of time that they thought would be needed to implement the new *Leases* Standard. This is because, ideally, they would develop and

implement any required system changes before the beginning of the earliest comparative period being restated.

Relevant decisions made during redeliberations - transition

6. At the February and March 2015 Board Meetings, the IASB redeliberated the transition proposals in the 2013 ED. Amongst other things, the IASB decided that:

   (a) an entity is not required to restate its comparative figures on transition to the new *Leases* Standard;

   (b) a lessee is not required to apply the requirements of the new *Leases* Standard to those leases for which the lease term ends within 12 months of the date of initial application;

   (c) a lessee has a choice of measurement approaches for right-of-use assets on transition. One of the options available is to measure the right-of-use asset equal to the lease liability at the date of initial application. This approach is expected to be used for high-volume low-value leases and does not require any backward looking information to be captured on transition to the new *Leases* Standard; and

   (d) an entity is not required to reassess whether a contract contains a lease on transition to the new *Leases* Standard.

7. These decisions were made in the light of feedback received, mainly from preparers of financial statements. On the basis of this feedback, the staff expect that the additional transition reliefs decided upon by the IASB (beyond those that were proposed in the 2013 ED) will give rise to a significant reduction in the time and costs needed to initially implement the requirements of the new *Leases* Standard.

8. In the light of these decisions, the staff have performed additional outreach with respect to the effective date of the new *Leases* Standard. This is because we think that it is important to understand whether and how stakeholder’s views on the effective date have changed in the light of the additional transition reliefs

described above. The feedback received from this outreach is described in paragraphs 16-30.

Recently issued Standards

9. Two recently issued Standards have an effective date of 1 January 2018. These are IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*.

10. IFRS 9 interacts with the new *Leases* Standard mainly in relation to lessor accounting. In particular, the new *Leases* Standard will require:

    (a) a lessor to apply the derecognition and impairment requirements of IFRS 9 to the net investment in a finance lease; and

    (b) in some cases, a lessor to account for a finance lease modification in accordance with IFRS 9.

11. IFRS 15 interacts with the new *Leases* Standard in several ways. In particular, the new *Leases* Standard will require:

    (a) licenses of intellectual property granted by a lessor to be accounted for in accordance with IFRS 15 and not in accordance with the new *Leases* Standard;

    (b) a lessor to allocate consideration in a contract in accordance with the requirements of IFRS 15;

    (c) a manufacturer or dealer lessor to recognise selling profit on entering into a finance lease in accordance with its policy for outright sales in accordance with IFRS 15; and

    (d) an entity to apply IFRS 15 when determining whether the transfer of an asset should be accounted for as a sale in the context of sale and leaseback transactions.

12. IFRS 9 and IFRS 15 affect the effective date considerations for the new *Leases* Standard in three ways:

    (a) the consequences for practical implementation of the new *Leases* Standard—ie is it feasible for preparers to first implement IFRS 9, IFRS 15 and the new *Leases* Standard on the same date?

    (b) the consequences for reported information—ie the effect of all accounting changes occurring together versus being spread over several reporting periods for users of financial statements.

    (c) the interaction between the new *Leases* Standard and other recently issued Standards if early application is permitted—ie could an entity apply the new *Leases* Standard before either or both of IFRS 9 and IFRS 15?

Outreach

Overview

13. The staff contacted preparers that had specifically commented on the effective date in their response to the 2013 ED. We also contacted some additional preparers in Asia because we did not receive any feedback from Asian constituents following the initial round of outreach.

14. Preparers were asked to respond to three questions:

    (a) How long do you think you would need to implement the new *Leases* Standard following publication (taking into account the new transition reliefs decided upon by the IASB)?

    (b) Would you prefer the effective date of the new *Leases* Standard to be aligned with that of IFRS 15 or to be a subsequent year (for information, the IASB has recently proposed an effective date of 1 January 2018 for IFRS 15, although this date is still to be decided upon)?

    (c) Would you prefer early application of the new *Leases* Standard to be permitted?

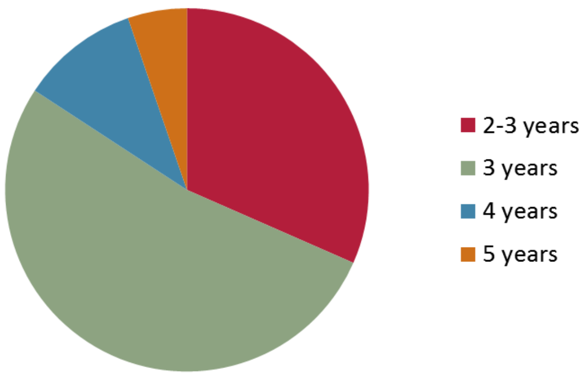
15. At the time of asking these questions, an Exposure Draft had been issued which proposed deferring the effective date of IFRS 15 by one year to 1 January 2018. This proposal was subsequently confirmed by the IASB in July 2015.

Feedback from Preparers

16. In total, the staff contacted 45 preparers and preparer groups and received 19 responses. 12 of these were from individual preparers and 7 were from preparer groups, representing up to 31 individual preparers. Responses were received from preparers and preparer groups around the world operating in the airline, automobile, banking, energy, equipment leasing, insurance, oil and gas, retail, telecommunications and travel industries.

Feedback received on Question 1: How long do you think you would need to implement the new Leases Standard following publication?

17. The following diagram summarises the feedback received on Question 1:



18. The majority of respondents stated that, in their view, three years (or between two and three years) would be required to implement the new *Leases* Standard following publication. Respondents held this view for one of two reasons:

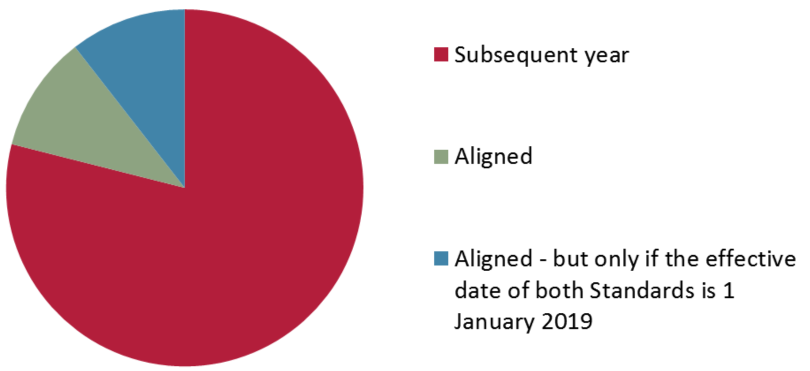
    (a) most thought that the amount of work involved in implementing the new *Leases* Standard would be too onerous to complete in less than three years. Some of these respondents provided detailed summaries of the steps involved in implementing the new *Leases* Standard—these are described in the Appendix to this paper.

(b) a few based their view on the effective date of IFRS 15 being two years after the expected publication date of the new *Leases* Standard. These respondents thought that two years would be sufficient time to implement the new *Leases* Standard in isolation. However, in their view, two years would not be sufficient to implement both the new *Leases* Standard and IFRS 15.

19. A small number of respondents thought that the effective date of the new *Leases* Standard should be four or five years after publication—ie 1 January 2020 or 1 January 2021. These respondents were of the view that four or five years would be needed to implement the requirements of the new *Leases* Standard because IFRS 15 and IFRS 9 would also need to be applied for the first time during this period. These respondents also noted that, in their view, there should be at least one year of 'stability' between implementing the requirements of IFRS 15 and implementing the requirements of the new *Leases* Standard.

Feedback received on Question 2: Would you prefer the Effective Date of the new Leases Standard to be aligned with that of IFRS 15 or to be a subsequent year?

20. The following diagram summarises the feedback received on Question 2:

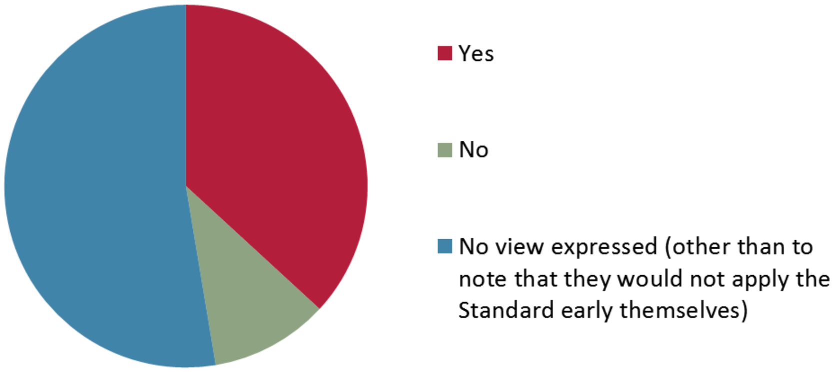


21. The vast majority of respondents stated that they would prefer the effective date of the new *Leases* Standard to be after the effective date of IFRS 15. Many respondents noted that the same resources would be needed to implement the new *Leases* Standard and IFRS 15 and, consequently, that it would be difficult and costly to implement both of these Standards at the same time.

22. A small number of respondents stated that they would prefer the effective date of the new *Leases* Standard to be the same as that of IFRS 15. These respondents thought that there would be benefit in minimising the number of incomparable reporting periods. However, about half of these respondents also stated that aligning the effective date of the new *Leases* Standard and IFRS 15 would be feasible only if the effective date of *both* Standards were to be 1 January 2019.

Feedback received on Question 3: Would you prefer early application of the new Leases Standard to be permitted?

23. The following diagram summarises the feedback received on Question 3:



24. Virtually all respondents that commented on early application stated that they would not apply the new *Leases* Standard early themselves if this were to be permitted.

25. Nonetheless, several respondents stated that they support early application being permitted. These respondents noted that permitting early application would enable those entities that prefer to first apply the new *Leases* Standard and IFRS 15 at the same time to do so. They also noted that early application might be of practical benefit for first time adopters of IFRS (ie entities that adopt IFRS between publication of the new *Leases* Standard and its mandatory effective date).

26. A small number of respondents stated that they do not support early application being permitted. These respondents thought that permitting early application might hinder comparability between entities.

Feedback from Users of Financial Statements

27. The staff also spoke to a few investors and analysts (users) about the effective date of the new *Leases* Standard.

28. All of these users strongly supported an effective date of 1 January 2018. This is for several reasons:

    (a) users do not want to see any further delay to the introduction of the new *Leases* Standard.

    (b) the introduction of significant accounting changes (ie to revenue and to leases) in different years means that there is accounting uncertainty for a lengthy period of time.

    (c) users generally need to make adjustments to historical data on the introduction of any significant new Standard. This is less time consuming and complicated to do if several accounting changes are implemented together at the same time.

29. Some users acknowledged that it might be more difficult for preparers to implement both IFRS 15 and the new *Leases* Standard on the same date compared to implementing either one in isolation. However, they also observed that preparers have been aware of both of these Standards for a long time. In their view, preparers have had the opportunity to plan for the implementation of these Standards and that, consequently, they would expect it to be feasible to implement both Standards together.

30. Users had differing views on whether they would prefer early application of the new *Leases* Standard to be permitted. Some think that early application should be permitted if the effective date is 1 January 2019—this is to enable entities to first apply the new *Leases* Standard at the same time as IFRS 15 if they (and their stakeholders) wish to do so. Others do not support early application because they find it unhelpful to have different entities applying a new Standard on different dates.

Staff Analysis

Effective date

1 January 2018

31. The main argument to support an effective date of 1 January 2018 is that it would be beneficial to users. All users consulted on this topic supported an effective date of 1 January 2018 for the reasons described in paragraph 28. In particular, it would be beneficial to users if IFRS 9, IFRS 15 and the new *Leases* Standard had the same effective date. This approach would limit the period of accounting uncertainty introduced by these significant new Standards and enable users to deal with the accounting changes more efficiently.

32. In addition, some preparers might view an effective date of 1 January 2018 as less costly and, thus, preferable. For those that would have sufficient resources to implement IFRS 9, IFRS 15 and the new *Leases* Standard at the same time, implementing all of these Standards on the same date might be less costly overall and the resulting changes may be easier to communicate to investors and others if they happen at the same time. We think that the significant amount of relief provided on transition to the new *Leases* Standard makes a two-year implementation period at least possible for entities. For example, entities would need to have systems and processes updated to apply the new *Leases* Standard only on 1 January 2018, and would not have to run any parallel systems in periods before 2018 for the purposes of financial reporting. Entities also would not be required to relook at contracts entered into before 2018 to determine the population of contracts to which the new requirements apply.

33. Nonetheless, the feedback from preparers who participated in the outreach did not reflect this view. Consequently, although acknowledging the significant benefits of this approach for users, the staff do not recommend that the IASB sets an effective date for the new *Leases* Standard of 1 January 2018. This is because the feedback received from the preparers consulted indicates that an effective date of 1 January 2018 would not be feasible for all entities in terms of practical implementation—particularly in the light of the effective dates of IFRS 9 and IFRS 15.

1 January 2019

34. The feedback received indicates strong preparer support for an effective date of 1 January 2019. In particular:

    (a) the majority of preparers think that three years will be needed between publication and the effective date to implement the requirements of the new *Leases* Standard; and

    (b) those preparers who think that two years would be sufficient to implement the new *Leases* Standard in isolation nonetheless think that three years should be permitted because of the effective date of IFRS 15.

35. The staff have also considered the implementation time allowed in other recently issued Standards. IFRS 9 and IFRS 15 both have a period between the publication date and the effective date of over three years. An effective date for leases of 1 January 2018 would mean a period of only two years between publication and the effective date.

36. Based on the feedback received, the staff think that 1 January 2019 would give preparers sufficient time to implement the new *Leases* Standard effectively. The staff's views have been influenced by the effective dates of both IFRS 9 and IFRS 15, as well as the significance of the change in financial reporting for many entities. If the new *Leases* Standard were to be implemented at a time when that Standard was the only significant change in financial reporting, the staff would have viewed a two-year implementation period (ie 1 January 2018) as sufficient in the light of the substantial transition relief described in paragraph 6 of this paper. However, the staff have not recommended an effective date of 1 January 2018 because of the significance of the change in financial reporting for leases (which is likely to result in systems changes for some entities), together with the fact that entities will also be implementing IFRS 9 and IFRS 15 in the period leading up to 1 January 2018.

37. Consequently, the staff recommend that the IASB sets an effective date for the new *Leases* Standard of 1 January 2019.

Early application

38. The majority of preparers that provided views on early application supported early application being permitted in the new *Leases* Standard, although virtually all preparers noted that they would not apply the Standard early themselves. Mixed views were received from users on this topic as described in paragraph 30 of this paper.

39. Early application of new Standards is often permitted. This approach enables entities to introduce improvements to financial reporting as soon as they are able to do so. The staff think that permitting early application of the new *Leases* Standard also has the following advantages:

    (a) it enables those entities who prefer to apply the new *Leases* Standard at the same time as IFRS 15 to do so;

    (b) it will benefit any entities who adopt IFRS for the first time between publication of the new *Leases* Standard and its effective date. If early application is not permitted, these entities would need to initially apply IAS 17 *Leases* and subsequently apply the new *Leases* Standard from 1 January 2019. The staff think that it will be easier and less costly for these entities to apply the new *Leases* Standard from the date they first adopt IFRS as a whole.

40. The main disadvantage of permitting early application is the potential consequences for comparability between those entities that apply the new *Leases* Standard early and those that do not. The staff note that this disadvantage exists in relation to all new Standards that permit early application. Some users oppose early application for this reason. However, the staff note the following:

    (a) preparers that provided feedback on this topic indicated that they would not apply the new *Leases* Standard early themselves. The staff think this feedback indicates that early application is likely to occur only in a small proportion of cases (such as first time adopters of IFRS and those entities that are not significantly affected by the new *Leases* Standard). Consequently, we think that the comparability risk highlighted by some users will occur only infrequently.

(b) it is expected that the effect of the new *Leases* Standard will vary across industries. For example, the financial statements of entities in some industries (such as retailers and airlines) will be significantly affected while others will not. The staff think that a decision to apply the new *Leases* Standard early is unlikely to be made by entities in those industries that are significantly affected by the new Standard. This is because for those entities the work involved in implementing the Standard will be more onerous. We think that any comparability issues will therefore generally be limited to entities in industries that are not significantly affected by the new *Leases* Standard.

41. The staff think that the advantages of permitting early application outweigh the concerns. Consequently, we recommend that the IASB permits early application of the new *Leases* Standard.

Interaction with other recently issue Standards

IFRS 9

42. The interaction between IFRS 9 and the new *Leases* Standard mainly relates to lessor accounting. The lessor accounting requirements in the new *Leases* Standard are substantially the same as in IAS 17. Consequently, we think that the interaction of IFRS 9 with lease accounting will be substantially the same, irrespective of when an entity applies the new *Leases* Standard.

43. Therefore, we do not recommend including any particular requirements relating to the interaction of the effective date of the new *Leases* Standard and that of IFRS 9.

IFRS 15

44. There are several ways in which the new *Leases* Standard interacts with IFRS 15, as described in paragraph 11 of this paper. In addition, the staff note that some of these interactions would not work with reference to IAS 18 *Revenue* (or other superceded Standards). For example, the new *Leases* Standard refers to an entity transferring an asset in accordance with IFRS 15 within the requirements relating to sale and leaseback transactions—this means assessing whether the buyer-lessor

obtains control of the asset. Because IAS 18 does not include a control principle, this interaction would not work for an entity that had not yet applied IFRS 15.

45. Furthermore, we note that the IASB's discussions throughout the *Leases* project have, when relevant, taken place in the context of the revenue recognition requirements in IFRS 15 and not those in IAS 18 (or other superceded Standards).

46. Consequently, the staff think it is important that an entity applies IFRS 15 before (or at the same time) as the new *Leases* Standard. We therefore recommend that, if the IASB decides to permit early application of the new *Leases* Standard, it prohibits entities from applying the new *Leases* Standard before applying IFRS 15.

Staff Recommendations and Questions for the IASB

Questions: Effective Date

1. Does the IASB agree with the following staff recommendations:

    a) to require entities to apply the new *Leases* Standard for annual periods beginning on or after 1 January 2019;

    b) to permit early application of the new *Leases* Standard, subject to the recommendation in paragraph (c) below;

    c) to prohibit entities from applying the new *Leases* Standard before applying IFRS 15 (an entity would be permitted to apply both the new *Leases* Standard and IFRS 15 for the first time in the same reporting period)?

Appendix: Costs for preparers of implementing the new *Leases* Standard

A1. The majority of preparers that provided feedback on the effective date of the new *Leases* Standard stated that, in their view, three years (or between two and three years) would be required between publication and the effective date. Some of these preparers supported this view by providing detailed lists of the steps involved in implementing the new *Leases* Standard. These included the following:

(a) read and understand the detail in the new *Leases* Standard;

(b) review contracts to determine whether they contain a lease (if transition relief not taken);

(c) define policy/threshold for the low-value asset leases exemption and review contracts to determine whether they are captured by the exemption;

(d) review contracts that contain a service component for which the distinction between the lease and service components may not have been made previously (because the results would have been immaterial for financial reporting under IAS 17);

(e) define policy for use of the portfolio approach and identify portfolios of similar contracts;

(f) assess transition options and determine approach;

(g) capture group wide data;

(h) measure lease liabilities and right-of-use assets;

(i) prepare supporting documentation for each lease, including key judgements;

(j) create/acquire, implement and configure systems, including:

    (i) external reporting management system;

    (ii) capital asset system;

    (iii) forecast/budgeting tools;

(k) establish ongoing processes to evaluate future leases/make key judgements;

(l) determine implications of the new *Leases* Standard, including:

   (i) impact on debt covenants (renegotiate/revise agreements where necessary);

   (ii) impact on credit rating;

   (iii) impact on ratios (establish new internal and external targets where necessary);

   (iv) impact on compensation models;

   (v) impact on other accounting areas such as deferred tax;

(m) educate stakeholders about the implications of the new *Leases* Standard;

(n) reconcile business strategies and performance reporting to the new *Leases* Standard;

(o) update accounting policies;

(p) design/implement new internal procedures and controls; and

(q) train staff.